

# The South in the World Economy: Past, Present and Future

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# The South in the World Economy: Past, Present and Future

DEEPAK NAYYAR

## ABSTRACT

This paper analyses the evolution of developing countries in the world economy from a long-term historical perspective, with a focus on the second half of the 20th century. It highlights the dominance of the South until about two centuries ago, and traces its decline and fall from 1820 to 1950. It shows that the period since 1950 has witnessed an increase in developing countries' share of world population, income, international trade and industrial production, with a gathering momentum after 1980, but also that this resurgence is associated with unequal distribution and uneven development, which excludes countries and people from the process. It argues that the future prospects of developing countries and their ability to sustain their rise depend on their capacity to combine economic growth with human development and social progress.

## INTRODUCTION

This paper begins by examining changes in the economic importance of Africa, Asia and Latin America (the developing world), compared with Western Europe, Eastern Europe, North America and Japan (the industrialized world) from a historical perspective.<sup>1</sup> It highlights the dominance of the South until about 200 years ago, and traces its decline and fall from 1820 to 1950.

Section 2 considers changes in the significance of developing countries in the world economy since 1950. It reveals an increase in their share of world population and income, international trade and investment, industrial production and manufactured exports, with gathering momentum since 1980.

Section 3 analyses factors underlying the rise of the South, and discusses catch-up in economic growth and industrialization. Section 4 disaggregates the impressive performance of the developing world to argue that this rise is associated with unequal participation and uneven development. Indeed,

the process excludes countries and people, so that economic growth has not been transformed into meaningful development that improves broader well-being. In conclusion, Section V suggests that the future prospects of developing countries and their ability to sustain their rise depend on their capacity to combine economic growth with human development and social progress.

## 1. A HISTORICAL PERSPECTIVE

The division of the world into industrialized and developing countries is more recent than widely believed. A historical perspective suggests a distinction between the period before the 19th century, when geography divided the world, and the period since then, when the world came to be divided by economics.

### DOMINANCE: 1000 TO 1700

Table 1 shows the regional distribution of population and income in the world economy from 1000 to 1700. At the end of the first millennium, Asia, Africa and Latin America together accounted for 82 percent of world population and 83 percent of world income.<sup>2</sup> Their overwhelming importance

1 This distinction between the developing world and the industrialized world, defined in terms of geographical regions, is used in setting out a historical perspective based on statistics compiled by Maddison (2003). The definition of the developing world is exactly the same throughout the paper. In the discussion on the world economy's evolution since 1950, the industrialized world comprises countries in Western Europe and North America, as well as Japan, Australia and New Zealand (the 21 countries that were original members of the Organisation for Economic Co-operation and Development or OECD). The transition economies of Eastern Europe and the former Soviet Union are excluded because the statistics available are not always complete or consistent.

2 The dominance of these three continents was similar and somewhat greater earlier. Two thousand years ago, in 1 AD, they accounted for 84 percent of both world population and income (Maddison 2003, p. 261).

**Table 1: Distribution of population and income in the world economy: 1000 - 1700**

	World Population (%)				World GDP %			
	1000	1500	1600	1700	1000	1500	1600	1700
<b>Group I</b>								
<i>Asia</i>	65.6	61.2	64.7	62.1	67.6	61.9	62.5	57.7
<i>Africa</i>	12.1	10.6	9.9	10.1	11.7	7.8	7.1	6.9
<i>Latin America</i>	4.3	4.0	1.7	2.0	3.9	2.9	1.1	1.7
<b>Group Total</b>	<b>82.0</b>	<b>75.8</b>	<b>76.3</b>	<b>74.2</b>	<b>83.3</b>	<b>72.5</b>	<b>70.7</b>	<b>66.3</b>
<b>Group II</b>								
<i>Western Europe</i>	9.5	13.1	13.3	13.5	8.7	17.8	19.8	21.9
<i>Western Offshoots</i>	0.7	0.6	0.4	0.3	0.7	0.5	0.3	0.2
<i>Eastern Europe</i>	2.4	3.1	3.0	3.1	2.2	2.7	2.8	3.1
<i>Former USSR</i>	2.6	3.9	3.7	4.4	2.4	3.4	3.5	4.4
<i>Japan</i>	2.8	3.5	3.3	4.5	2.7	3.1	2.9	4.1
<b>Group Total</b>	<b>18.0</b>	<b>24.2</b>	<b>23.7</b>	<b>25.8</b>	<b>16.7</b>	<b>27.5</b>	<b>29.3</b>	<b>33.7</b>
<b>TOTAL</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

*Note:* Asia includes China and India with a regional estimate for other countries in Asia. Western Europe includes Austria, Belgium, Denmark, Finland, Germany, Italy, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland and the United Kingdom, with a residual estimate for others in the region. Western offshoots include the United States with a residual estimate for others. Latin America includes Mexico with a separate residual estimate for others in the region. Africa includes estimates for selected countries in the north, west, east and south, with residual estimates for others.

*Source:* Nanyar 2009 based on Maddison 2003.

continued in the second millennium. Even in 1500, they accounted for about 75 percent of population and income. Two centuries later, in 1700, their share of population remained almost the same at three-fourths, but their share of income declined to two-thirds. Their dominance was attributable, in large part, to just two countries. From 1000 to 1700, China and India together accounted for 50 percent of world population and income.

Western Europe, Eastern Europe, North America, Oceania and Japan together were far less important in the world economy. Their share of world population increased from less than one-fifth in 1000 to about one-fourth in 1700, and their share of world income rose from one-sixth to one-third. The second half of the second millennium witnessed the beginnings of change, in part attributable to the first phase of European colonial expansion in the late 15th century in the Caribbean and the Americas. It started with Portugal and Spain, followed by England and France.<sup>3</sup> The slave trade from Africa, the

3 For a succinct analysis of the rise of these countries during that era, see Kindleberger 1996. See also, Reinert 2007.

search for gold and silver in the new world, the colonization of the Americas and the rise of the Asian entrepôt trade were parts of a process that unleashed a different phase in the world economy from the early 16th century to the late 18th century.<sup>4</sup> It was the age of mercantilism in Europe, and Western Europe's share of world income discernibly increased. This period also witnessed the beginnings of a division of labour between primary producers and manufacturers, but the organization of production was essentially pre-capitalist. The onset of the Industrial Revolution, at the end of this era, introduced the possibilities of structural transformation in the world economy.

#### DECLINE AND FALL: 1820 TO 1950

The 19th century witnessed the evolution of an international economic order leading to profound change in the balance of economic and political power. The division of the world into rich industrialized countries and poor developing countries was the result of three developments. The first was the Industrial Revolution in Britain during the late 18th century, which spread to Western Europe during the first half of the 19th century. The second was the emergence of a newer, somewhat different form of colonialism in the early 1800s, which culminated in the advent of imperialism that gathered momentum through the 19th century. The third was the revolution in transport and communication in the mid-19th century, manifesting in the railway, telegraph and steamship.

These three developments overlapped and partly coincided in time as they transformed the world economy. They created patterns of specialization in production associated with a division of labour through trade reinforced by the politics of imperialism. There are competing explanations for this outcome. Some emphasize economic factors to argue that the Industrial Revolution was dependent on a prior or simultaneous agricultural revolution.<sup>5</sup> Some stress political factors to argue that imperial powers did not allow industrialization in their colonies.<sup>6</sup> Some highlight a mix of economic and political factors to contend that the economics of colonialism and the politics of imperialism together created this international economic order.<sup>7</sup>

The outcome was unambiguous, with the world economy divided into countries (mostly with temperate climates) that industrialized and exported manufactured goods, and

4 For a lucid discussion on the evolution of the world economy during this period, see Findlay and O'Rourke 2007.

5 This hypothesis is developed by Lewis 1978.

6 See, for example, Baran 1957.

7 This is the essential theme in the structuralist literature on underdevelopment in Latin America. See, for instance, Furtado 1970 and Griffin 1969. See also Frank 1971.

countries (mostly with tropical climates) that did not industrialize and exported primary commodities. Slowly but surely, countries in Asia, Africa and Latin America became dependent on the industrializing nations in Western Europe, not simply for markets and finance but also as their engine of growth.<sup>8</sup> High productivity in the agricultural sector, combined with the technological revolution in the industrial sector, allowed north-west Europe to industrialize rapidly. In contrast, Asia, Africa and Latin America, which had large agricultural sectors characterized by low productivity, ended up specializing in and exporting primary commodities at unfavourable terms of trade. The economic relationship between the two sets of countries was driven and reinforced by Europe's political dominance. This fostered de-industrialization and underdevelopment in what became the developing world, just as it led to industrialization and development in what became the industrialized world.<sup>9</sup> Both outcomes were an integral part of the evolution of capitalism in the world economy.

It is somewhat difficult to find a turning point for the division of the world economy. The process began around 1820, was discernible by 1870 and continued until 1950. Table 2 shows that between 1820 and 1950, developing countries' share of world population declined from three-fourths to two-thirds, but their share of world income witnessed a much more pronounced decline from 63 percent to 27 percent. Industrialized countries' population share rose from one-fourth to one-third, while their income share almost doubled from 37 percent to 73 percent.

This transformation may have spanned 130 years, but the new international economic order was clearly discernible at the end of 50 years. By 1870, developing countries' share of world population had decreased to two-thirds while that of industrialized countries had increased to one-third. The former's share of world income had fallen to 43 percent while that of the latter had risen to 57 percent.

For the world economy, the significance of 1870 is clear. The balance of power had shifted; the division of labour had changed. The gap between industrialized countries and developing countries had begun to widen. Between 1820 and 1950, there was a sharp increase in the asymmetries between their respective shares of world population and income.

It may, however, be misleading to consider developing countries as an aggregate, given significant regional differences. The increase in disproportionality between world

<sup>8</sup> For an elaboration of this hypothesis, with supporting arguments and evidence, see Lewis 1978.

<sup>9</sup> There is extensive literature on the historical origins of underdevelopment. See, for example, Baran 1957, Griffin 1969, Furtado 1970 and Frank 1971.

Table 2: The share of developing countries in world population and world GDP

	World Population %					
	1820	1870	1913	1950	1973	2001
<i>Africa</i>	7.1	7.1	7.0	9.0	10.0	13.4
<i>Asia</i>	65.2	57.5	51.7	51.4	54.6	57.4
<i>Latin America</i>	2.1	3.2	4.5	6.6	7.9	8.6
<i>Developing Countries</i>	74.4	67.8	63.2	67.0	72.5	79.4
<i>Industrialized Countries</i>	25.6	32.2	36.8	33.0	27.5	20.6
<i>World GDP</i>	1820	1870	1913	1950	1973	2001
<i>Africa</i>	4.5	4.1	2.9	3.8	3.4	3.3
<i>Asia</i>	56.4	36.1	22.3	15.4	16.4	30.9
<i>Latin America</i>	2.2	2.5	4.4	7.8	8.7	8.3
<i>Developing Countries</i>	63.1	42.7	29.6	27.0	28.5	42.5
<i>Industrialized Countries</i>	36.9	57.3	70.4	73.0	71.5	57.5

*Note:* The group of developing countries is made up of states in Africa, Asia and Latin America. The group of industrialized countries comprises Western Europe (Andorra, Austria, Belgium, Channel Islands, Denmark, Faeroe Islands, Finland, France, Germany, Gibraltar, Greece, Greenland, Iceland, Ireland, Isle of Man, Italy, Liechtenstein, Luxembourg, Monaco, Netherlands, Norway, Portugal, San Marino, Spain, Sweden, Switzerland and the United Kingdom), the Western offshoots (Australia, Canada, New Zealand and the United States), Eastern Europe (Albania, Bulgaria, the former Czechoslovakia, Hungary, Poland, Romania and the former Yugoslavia), the former Soviet Union and Japan.

*Source:* Nanyar 2009 based on Maddison 2003.

population and income shares was particularly pronounced in Asia. Between 1820 and 1950, its population share diminished from 65 percent to 51 percent, but its income share dropped from 56 percent to 15 percent. For Africa, the shares of population and income were relatively stable, although the latter was consistently lower. For Latin America, the shares were symmetrical and rose over the period. In 1950, Latin America's income share was higher than its population share.

Latin America was the exception in the developing world. During the 19th century, when countries in Asia and Africa were beginning to be colonized, those in Latin America were starting to attain independence. This process started in 1810 but was consolidated only in the 1820s. For this reason, perhaps, there was a slight increase, rather than a decline, in Latin America's share of world gross domestic product (GDP) between 1820 and 1870. The period thereafter witnessed the rise of the region as its GDP share more than trebled from 2.5 percent in 1870 to 7.8 percent in 1950. In sharp contrast, Asia's economic decline, which began in 1820, saw its GDP share drop by more than half, from 36.1 percent in 1870 to 15.4 percent in 1950.

Given changes in shares of world population and income, divergence in per capita income between developing and

Table 3: Comparing GDP per capita: divergence in GDP per capita between industrialized countries and developing countries

	Per Capita GDP ratios					
	1820	1870	1913	1950	1973	2001
<i>Western Europe</i>	100	100	100	100	100	100
<i>Western offshoots</i>	100	100	100	100	100	100
<i>Eastern Europe</i>	57.6	45.7	42.5	33.5	37.3	26.4
<i>Latin America</i>	57.5	33.2	37.1	39.8	33.7	25.5
<i>Africa</i>	34.9	24.4	16.0	14.2	10.5	6.5
<i>Asia</i>	48.0	26.8	16.5	10.1	9.2	14.3
<i>Japan</i>	55.6	36.0	34.8	30.5	85.5	90.6
<i>China</i>	49.9	25.8	13.8	7.0	6.3	15.7
<i>India</i>	44.3	26.0	16.9	9.8	6.4	8.6

Note: Western Europe includes Andorra, Austria, Belgium, Channel Islands, Denmark, Faeroe Islands, Finland, France, Germany, Gibraltar, Greece, Greenland, Iceland, Ireland, Isle of Man, Italy, Liechtenstein, Luxembourg, Monaco, Netherlands, Norway, Portugal, San Marino, Spain, Sweden, Switzerland and the United Kingdom. The Western offshoots include Australia, Canada, New Zealand and the United States. Japan's figures are excluded from Asia's figures, but China's and India's figures are included. Eastern Europe excludes the former Soviet Union, but includes Albania, Bulgaria, the former Czechoslovakia, Hungary, Poland, Romania and the former Yugoslavia.

Source: Nayyar 2009 based on Maddison 2003.

industrialized countries increased rapidly, as confirmed in Table 3. Between 1820 and 1950, as a percentage of GDP per capita in Western Europe, North America and Oceania together, GDP per capita in Latin America dropped from three-fifths to two-fifths, in Africa from one-third to one-seventh, and in Asia from one-half to one-tenth. The divergence was modest in Latin America, massive in Asia and somewhere in the middle for Africa. And it was not confined to developing countries alone, but extended to Eastern Europe and Japan. Over 130 years, Western Europe and North America pulled away from the rest of the world.

In sum, the evolution of the world economy during this era was shaped by two sets of factors. The first set, from 1820 to 1870, included the Industrial Revolution, the emergence of colonialism, and the revolution in transport and communication.<sup>10</sup> The second set, from 1870 to 1914, encompassed the politics of imperialism and the economics of globalization, which created winners and losers.<sup>11</sup> The influence of these factors possibly waned from 1914 to 1950, a period with the two World Wars and the Great Depression, but the inherent logic and essential characteristics of industrial capitalism meant that uneven development for unequal partners persisted.<sup>12</sup>

10 See Lewis 1978, Bairoch 1993, and Findlay and O'Rourke 2007.

11 See Hobsbawm 1987, Rodrik 1997, Williamson 2002 and Nayyar 2006.

12 For a discussion on developing countries during this period, see Bairoch 1975.

## 2. DEVELOPING COUNTRIES IN THE WORLD ECONOMY SINCE 1950

In 1950, the post-colonial era began as newly independent countries in Asia and Africa sought to catch up in industrialization and development. Table 2 suggests two phases during the second half of the 20th century: 1950 to 1973 and 1973 to 2001.

From 1950 to 1973, developing countries' share of world population rose from 67 percent to 72.5 percent, while their share of world income stopped its decline and rose modestly from 27 percent to 28.5 percent. There was a corresponding decline in industrialized countries' shares of population and income, even though this was the golden age of capitalism, associated with their rapid economic growth.<sup>13</sup>

While economic growth was somewhat faster in the developing world, Asia's share of global population rose more than its share of income, so asymmetry persisted. Africa's share of population rose a little while its share of income fell a little. Latin America's shares of population and income registered a discernible increase and were roughly symmetrical.

Given rapid population growth across the developing world, divergence in income per capita increased everywhere, significantly in Africa and Latin America, but only a little in Asia. Between 1950 and 1973, as a percentage of GDP per capita in Western Europe, North America and Oceania taken together, GDP per capita in Latin America dropped from 39.8 percent to 33.7 percent, in Africa from 14.2 percent to 10.5 percent, and in Asia from 10.1 percent to 9.2 percent.

From 1973 to 2001, industrialized countries' share of world population fell from 27.5 percent to 20.6 percent, while their share of world income declined from 71.5 percent to 57.5 percent. There was a corresponding increase in developing countries' shares. Asia's population share increased from 54.6 percent to 57.4 percent, while its income share rose from 16.4 percent to 30.9 percent. Africa's population share went from 10 percent to 13.4 percent, while its income share decreased from 3.4 percent to 3.3 percent. Latin America's population share rose from 7.9 percent to 8.6 percent, while its income share fell from 8.7 percent to 8.3 percent, but these proportions remained close to each other.

For Africa and Latin America, the divergence from industrialized countries in per capita income continued to increase, but for Asia this divergence, though still large, diminished. Between 1973 and 2001, as a percentage of GDP per capita in Western Europe, North America and Oceania together, GDP

13 See Marglin and Schor 1990.

per capita in Latin America dropped from 33.7 percent to 25.5 percent, and in Africa from 10.5 percent to 6.5 percent, but in Asia it rose from 9.2 percent to 14.3 percent.

Latin America continued to be an exception in the developing world until 1973. It fell behind the industrialized world, but at a slower rate than Asia and Africa. After 1950, Asia became the exception as its economic decline stopped from 1950 to 1973, and its catch-up with the industrialized world accelerated from 1973 to 2001.

The preceding discussion is based on estimates made by Maddison (2003). These relate to three selected benchmark years over five decades. The focus is on percentage shares of world population or income, and on proportional divergence or convergence in per capita income. The percentages and proportions are derived from data on income in 1990 international Geary-Khamis dollars, which are purchasing power parities (PPPs), more sophisticated than the usual, that facilitate inter-country comparisons over time. This exercise is conducive to studying long-term trends, particularly if the object is to compare the 50 years since 1950 with the preceding 130 years.

## POPULATION

A perspective on changes in population, particularly during the second half of the 20th century, requires some reference to absolute magnitudes. Table 4 shows that the size of the population in Asia, Africa and Latin America increased from 1.7 billion in 1950 to 5.7 billion in 2010. This was attributable, in large part, to demographic factors, as death rates dropped but birth rates did not. Developing countries' share of world population increased from two-thirds in 1950 to more than four-fifths in 2000. This was due to their rapid population growth and relatively stable populations in industrialized countries.

Developing countries' population share in 1980 had returned to its level from 1500 to 1820. By 2010, the share reached its level in 1000. Growth was concentrated in Asia and Africa. As in the past, China and India were once again home to a major proportion of world population, together accounting for about 36 percent compared with much larger shares of 50 percent in 1000 and 57 percent in 1820. Several other countries in Asia and Africa had large and rapidly growing populations.

## OUTPUT AND INCOME

Analysing trends in GDP and GDP per capita since 1950 calls for considering evidence at market exchange rates rather than just PPPs. Computation of GDP per capita in terms of PPP may be helpful for international comparisons of relative

Table 4: Share of developing countries in world population: 1950 to 2010

Year	Population (in billions)		
	World	Developing countries	Developing countries' share (%)
1950	2.5	1.7	68.0
1955	2.8	1.9	68.9
1960	3.0	2.1	69.9
1965	3.3	2.4	71.1
1970	3.7	2.7	72.8
1975	4.1	3.0	74.3
1980	4.5	3.4	75.7
1985	4.9	3.7	77.0
1990	5.3	4.1	78.3
1995	5.7	4.5	79.4
2000	6.1	4.9	80.5
2005	6.5	5.3	81.3
2010	6.9	5.7	82.1

Source: United Nations, Population Division, UNDATA.

standards of living. But it is not quite correct to add up GDP in terms of PPP across countries to estimate shares of world GDP in terms of PPP. These estimates are based on an artificial upward adjustment in the price of non-traded goods and services in developing countries.<sup>14</sup> This leads to an upward bias in PPP-GDP estimates for developing countries, which are thus not comparable with other macroeconomic variables such as foreign trade, international investment or industrial production valued at market prices.

Developing countries' shares of world GDP at current prices and at market exchange rates increased from 17.5 percent in 1970 to 30.7 percent in 2010.<sup>15</sup> Differences in inflation rates and movements in exchange rates significantly influenced these trends. To resolve problems arising from different inflation rates, Table 5 presents available evidence on GDP and GDP per capita, at constant 2000 prices, from 1970 to 2010. GDP in developing countries as a proportion of world GDP increased from 14.7 percent in 1970 to 25.4 percent in 2010. GDP per capita as a proportion of that in industrialized countries remained almost unchanged in the range

14 In principle, this could be a problem for the Maddison (2003) estimates used in the preceding discussion. In fact, it is not, as the Maddison-Geary-Khamis approach is a more sophisticated exercise in international comparisons than the conventional PPP measures and is suitable for a study of long-term trends. For a more detailed discussion, see Nayyar 2009.

15 These percentages are calculated from data on GDP at current market prices reported in World Bank 2011.

**Table 5: GDP and GDP per capita in developing countries and the world economy (at constant prices)**

Year	Developing countries GDP	World GDP	Gdp of developing countries as % of world GDP	Developing countries Per capita GDP	Industrialized countries per capita GDP	Per capita GDP of developing countries as % of per capita GDP of industrialized countries
1960	1134	7279	15.6	484	9144	5.3
1965	1424	9420	15.1	550	11190	4.9
1970	1792	12153	14.7	628	11660	5.4
1975	2355	14598	16.1	739	13028	5.7
1980	2991	17652	16.9	849	14887	5.7
1985	3435	20275	16.9	883	16468	5.4
1990	4048	24284	16.7	943	18937	5.0
1995	4756	27247	17.5	1019	20088	5.1
2000	5872	32213	18.2	1167	22708	5.1
2005	7646	36926	20.7	1423	24282	5.9
2010	10516	41365	25.4	1840	24635	7.5

Note: GDP figures are in billions of constant 2000 US dollars. GDP per capita figures are in constant 2000 US dollars.

Source: World Bank 2011.

of 5 percent between 1970 and 2000. It rose to 5.9 percent in 2005 and 7.5 percent in 2010. Divergence in per capita income seemingly came to a stop in the last quarter of the 20th century. Convergence did not quite begin for the developing world as a whole until the turn of the century, although a few countries in Asia witnessed a significant catch-up in terms of per capita income starting somewhat earlier.

The focus on population and income, while instructive, is not sufficient. Considering the engagement of developing countries with the world economy through obvious channels such as international trade and investment is important, as is exploring whether or not developing countries succeeded in catching up in industrialization. This should be reflected in developing countries' share of world industrial production and manufactured exports. The discussion that follows considers these aspects.

### INTERNATIONAL TRADE

International trade is, perhaps, the most important form of engagement with the world economy. Table 6 shows that the share of developing countries in world exports increased from 14.4 percent in 1970 to 42 percent in 2010. Their share of world imports also increased, from 14.1 percent in 1970 to 38.9 percent in 2010. As sources of imports and markets for exports, developing countries' shares more than doubled between 1990 and 2010. In 1970, their share of exports and imports was roughly commensurate with their share of world GDP, but by 2010 their share of the former was significantly higher than their share of the latter.

**Table 6: Share of developing countries in world trade**

Year	Exports (in US \$ billion)			Imports (in US \$ billion)		
	World	Developing countries	Developing countries' share (%)	World	Developing countries	Developing countries' share (%)
1970	161.9	23.3	14.4	170.2	23.9	14.1
1975	801.0	183.2	22.9	820.5	165.3	20.2
1980	1,745.0	426.5	24.4	1,812.9	355.0	19.6
1985	1,686.6	360.9	21.4	1,799.7	355.0	19.7
1990	3,132.0	617.4	19.7	3,251.0	613.3	18.9
1995	4,705.6	1,167.6	24.8	4,763.4	1,243.4	26.1
2000	6,074.2	1,803.3	29.7	6,263.4	1,663.0	26.6
2005	9,864.2	3,330.3	33.8	10,171.6	3,006.6	29.6
2010	15,229.6	6,395.6	42.0	15,262.4	5,931.3	38.9

Note: The data on exports and imports are in current prices at current exchange rates.

Source: Nayar 2009 based on the United Nations UNCOMTRADE Statistical Database.

Developing countries' share of world merchandise exports at current prices rose from 14.4 percent in 1870 to 19.6 percent in 1913.<sup>16</sup> Their share of world trade in 1970 was about the same as it was in 1870, but by 2010 it was double what it was in 1913.

16 These percentages have been calculated from data on the value of merchandise exports, in millions of US dollars in current prices at current exchange rates, for a sample of 56 countries reported in Maddison 1995 (pp. 234-235). This sample includes 28 developing countries (7 in Latin America, 11 in Asia and 10 in Africa) and 28 industrialized countries (17 in Western Europe, 2 in North America, 7 in Eastern Europe and 2 in Oceania). Based on data in this sample, the share of developing countries in world merchandise exports at current prices was almost unchanged at 20.4 percent in 1950.



Table 7: FDI in the world economy: 1990 to 2010

	Stocks										Flows (average per annum)							
	Inward					Outward					Inward				Outward			
	1990	1995	2000	2005	2010	1990	1995	2000	2005	2010	1991-1995	1996-2000	2001-2005	2006-2010	1991-1995	1996-2000	2001-2005	2006-2010
<i>Developing Countries</i>	517	848	1,732	2,701	5,951	146	330	857	1281	3,132	78	203	240	549	36	78	84	286
<i>Industrialized Countries</i>	1,562	2,534	5,653	8,563	12,502	1,948	3,281	7,083	10,983	16,804	148	604	490	891	222	696	641	1,262
<i>World</i>	2,081	3,393	7,446	11,539	19,141	2,094	3,616	7,962	12,416	20,408	228	815	750	1,521	259	776	735	1,597
<i>Developing Countries as a percentage of World total</i>	24.9	25.0	23.3	23.4	31.1	6.9	9.1	10.8	10.3	15.3	34.1	24.9	32.0	36.1	13.8	10.0	11.5	17.9

Source: UNCTAD Foreign Direct Investment Online Database ([www://stats.unctad.org/fdi](http://www://stats.unctad.org/fdi)).

### INTERNATIONAL INVESTMENT

Table 7 highlights how, between 1990 and 2010, developing countries' global share of inward foreign direct investment (FDI) stocks increased from about one-fourth to almost one-third, while their share of inward FDI flows was in the range of one-third. Their share of outward FDI stocks increased from less than one-fourteenth to more than one-seventh; outward FDI flow shares were in the range of one-tenth to one-sixth.

In 1900, foreign investment in developing countries, direct and portfolio together, was the equivalent of about one-third of their GDP.<sup>17</sup> In 2000, it was about 30 percent.<sup>18</sup> In 1914, foreign investment in developing countries, direct and portfolio together, was US \$179 billion at 1980 prices. In 1980, it was \$96 billion at 1980 prices.<sup>19</sup> In real terms, it reached its 1914 level in the mid-1990s.

For developing countries, the significance of foreign investment at the end of the 20th century was about the same as it was at the end of the 19th century.<sup>20</sup> There is, however, one important difference. In the 2000s, developing countries were an increasingly significant source of FDI in the world economy, an altogether new phenomenon.<sup>21</sup>

17 Maddison (1989) estimated that, at 1980 prices, in 1900, the stock of foreign capital in developing countries was \$108.3 billion (p. 30), while the GDP of 15 selected developing countries in Asia and Latin America was \$333.8 billion (p. 113).

18 UNCTAD 2002, p. 329. This proportion rose sharply in the late 1990s, as it was much less at 10.2 percent in 1980 and 13 percent in 1990.

19 The estimate of foreign capital stocks in developing countries in 1914, at 1980 prices, is from Maddison 1989 (p. 30), while the figure for FDI stocks in developing countries in 1980 is from UNCTAD 1993 (p. 248).

20 For evidence and analysis in support of this proposition, see Nayyar 2006.

21 For a detailed discussion, see UNCTAD 2006. See also Nayyar 2008a.

### INDUSTRIAL PRODUCTION

It is difficult to find time series evidence on industrial production in developing countries and the world economy since 1950. Problems arise from the comparability of data over time. Table 8 illustrates the shares of developing countries in manufacturing value added<sup>22</sup> with two time series. These are not strictly comparable because of index number problems, but some overlap between the series makes it easier to interpret trends. From 1975 to 1990, the share of developing countries in world manufacturing value added, at 1980 constant prices, registered a modest increase from 12.6 percent to 15.3 percent. From 1990 to 2010, the share, at 2000 prices, doubled from 16 percent to more than 32 percent, with accelerated gains beginning in the mid-1990s.

Developing countries' share of world industrial output was 60.5 percent in 1830.<sup>23</sup> But with industrialization in Western Europe and somewhat later in the United States, their share dropped sharply from 36.6 percent in 1860 to 11 percent in 1900 and 7.5 percent in 1913.<sup>24</sup> Particularly in Asia, a dramatic de-industrialization occurred from 1830 to 1913. Developing countries' share of world industrial production stayed in the 7-8 percent range, its 1913 level, until around 1970.<sup>25</sup>

### MANUFACTURED EXPORTS

The catch-up in industrialization was reflected in the emergence of developing countries as important sources of manufactured exports. Table 9 reveals that from 1975 to 1990,

22 Manufacturing value added reported in this table is estimated in accordance with the national accounting concept, which represents the contribution of the manufacturing sector to GDP.

23 These shares are estimated by, and reported in, Bairoch 1982 (p. 275).

24 Ibid., p. 275.

25 For supporting evidence, see Nayyar 2009 (p. 21).

their share multiplied by more than 2.5 times, from 6.8 percent in 1975 to 17.8 percent in 1990. From 1990 to 2010, their share continued rapidly increasing, more than doubling from 17.8 percent in 1990 to 36.5 percent in 2010.

Developing countries' share of world manufacturing value added was higher than their share of world manufactured exports until around 1980. The two shares were roughly similar through the 1980s, but beginning in the 1990s their share in manufactured exports progressively exceeded their share in manufacturing value added.

**Table 8: Share of developing countries in world manufacturing value added (percent)**

Year	Percentage Share		Exports
	1980 prices	2000 prices	
1975	12.6	...	6.8
1980	13.7	...	10.6
1985	14.1	...	14.6
1990	15.3	16.0	17.8
1995	...	19.8	25.2
2000	...	20.9	28.1
2005	...	25.4	33.3
2010	...	32.1	36.5

*Note:* The percentage figures have been calculated from data on US dollar values at constant prices for each of the series.

*Source:* Nayyar (2009) and UNIDO Secretariat.

**Table 9: Share of developing countries in world manufactured exports**

Year	Share (%)
1975	6.8
1980	10.6
1985	14.6
1990	17.8
1995	25.2
2000	28.1
2005	33.3
2010	36.5

*Note:* Manufactured goods are defined as products belonging to Standard International Trade Classifications (SITC) Sections 5 to 8, excluding Division 68 (non-ferrous metal products). Figures have been calculated from data on US dollar values at current exchange rates.

*Source:* Nayyar (2009) based on United Nations, UNCOMTRADE database.

### 3. UNDERLYING FACTORS

Changes in the significance of any subset of countries in the world economy over time depend on their economic growth as compared with the rest of the world. Table 10 presents GDP and GDP per capita growth rates over time, based on Maddison (2001) estimates in 1990 international Geary-Khamis dollars.

The progressive, rapid decline in the relative importance of developing countries in the world economy from 1820 to 1950 is easily explained in terms of slow GDP growth compared with Western Europe, North America, Eastern Europe and Japan. The differences in the relative importance of regions can also be explained in terms of variations in growth performance. From 1820 to 1950, the dramatic decline in Asia's share of global income was attributable to much slower GDP growth compared with every other part of the world. The relatively stable share of Africa stemmed from respectable GDP growth rates not significantly lower than elsewhere, whereas the sharp increase in Latin America's share derived from much higher GDP growth rates.

Divergences or convergences in per capita income between groups of countries that emerged over time are clearly reflected in differences in GDP per capita growth rates. From 1820 to 1950, there was a great divergence in per capita income between Western Europe and North America on the one hand, and Asia on the other, but this divergence was much less for Latin America and Africa. The divergence between Western Europe and Asia is striking, with sustained productivity growth and industrialization in Western Europe, and a steady productivity decline and de-industrialization in Asia. The rise of Western Europe and the decline of Asia are important themes in the historical literature on the subject.<sup>26</sup>

Around 1750, life expectancy, consumption levels and product markets in these two parts of the world were similar. Living standards were not far apart.<sup>27</sup> Advanced regions of Europe and Asia were more similar than different, with sophisticated economies. It has been argued that the great divergence between Europe and Asia during the 19th century was attributable to the fortunate location of coal, which substituted for timber, and trade with the Americas that allowed Western Europe to grow along resource-intensive and labour-saving paths.<sup>28</sup> Another hypothesis suggests that, during the 18th century, high wages combined with cheap capital and energy in Britain and other European countries, compared

26 For an extensive discussion, see Frank 1998, Pomeranz 2000 and Allen 2009. For an analysis in the wider context of the world economy, see Kindleberger 1996, and Findlay and O'Rourke 2007.

27 For a discussion, with supporting evidence, see Pomeranz 2000.

28 This argument is the essential theme in Pomeranz 2000.

Table 10: Growth rates in the world economy by regions: 1820 to 1950

	GDP			GDP per capita		
	1820 – 1870	1870 – 1913	1913 – 1950	1820 – 1870	1870 – 1913	1913 – 1950
<i>Asia</i>	0.03	0.94	0.90	-0.11	0.38	-0.02
<i>Africa</i>	0.52	1.40	2.69	0.12	0.64	1.02
<i>Latin America</i>	1.37	3.48	3.43	0.10	1.81	1.43
<i>Western Europe</i>	1.65	2.10	1.19	0.95	1.32	0.76
<i>Western Offshoots</i>	4.33	3.92	2.81	1.42	1.81	1.55
<i>Eastern Europe</i>	1.36	2.31	1.14	0.63	1.31	0.89
<i>Former Soviet Union</i>	1.61	2.40	2.15	0.63	1.06	1.76
<i>Japan</i>	0.41	2.44	2.21	0.19	1.48	0.89

Note: Western Europe includes 16 selected countries, Eastern Europe 7 selected countries, Asia 56 selected countries, Africa 57 selected countries and Latin America 44 selected countries. The Western offshoots include Australia, Canada, New Zealand and the United States.

Source: Nayyar 2009 based on Maddison 2001, Appendix A.

with Asia, meant that the technologies of the Industrial Revolution, whether the steam engine or the spinning jenny, were profitable to invent and use.<sup>29</sup>

These arguments cannot provide a complete explanation, for the basic causes were manifold and complex. The search for coal might have been driven by shortages of wood that followed deforestation at home. The search for new technologies might have come from competition from Asian manufacturers, whether of cotton textiles in India or porcelains and silks in China. In both Europe and Asia, events were shaped by complex national economic, social and political factors.<sup>30</sup> The global economy also exercised an important influence.<sup>31</sup> British military successes overseas played a significant role, with the origins of the Industrial Revolution closely connected with international trade and overseas expansion.<sup>32</sup>

Economic growth in Britain was also attributable to the organization of production in the capitalist system, based on a division of labour associated with capital accumulation and technical progress; this was strongly supported by state policies on industry and tariffs.<sup>33</sup> Countries in Western Europe followed a similar path a little later. But this did not happen in Asia.

29 This hypothesis is developed in Allen 2009.

30 For a discussion, see Kindleberger 1996.

31 It has been argued by Allen (2009) that the British Industrial Revolution was a successful response to the global economy of the 18th century.

32 For a discussion on the international context in which the Industrial Revolution happened in Britain, rather than elsewhere in Europe or Asia, see Findlay and O'Rourke 2007.

33 For a lucid and persuasive exposition of this hypothesis, see Chang 2002.

In terms of output and employment, industrialization in Britain and north-west Europe increased manufacturing and decreased agricultural activity, leading to an economic structural transformation. The shift of labour from agriculture to manufacturing led to sustained increases in productivity. International migration, which moved people from land-scarce Europe to land-abundant America, supported the process,<sup>34</sup> as did access to resources from colonies in the Americas and elsewhere.

Since 1950, complete time series data on GDP are available from national accounts statistics. Evidence suggests that 1980 marked a shift in economic growth trends almost everywhere in the world economy.<sup>35</sup> Table 11 presents evidence on growth rates in GDP and GDP per capita from 1951 to 2005. Both the arrest of the decline in the relative importance of developing countries in the world economy from 1951 to 1980 and the significant increase in the importance of developing countries since 1980 are explained by GDP growth rates higher than those in industrialized countries.

From 1951 to 1980, economic growth in all regions in the developing world was much better than it was from 1820 to 1950. Divergence within the developing world began thereafter. Asia's modest recovery in its share of world income after 1950, followed by its rapid rise since 1980, was attributable to much higher GDP growth rates than elsewhere. Economic growth in Latin America from 1951 to 1980 was comparable with that in industrialized countries, so that it increased its income share, but its growth performance was distinctly worse after 1980, with some decline in its share. Africa experienced a contraction in its share particularly after 1980, as GDP growth rates were lower than elsewhere in the world.

Economic growth in the developing world during the second half of the 20th century was not associated with convergence in per capita incomes compared with the industrialized world. The divergence in per capita incomes persisted. In fact, for Latin America and Africa, this significantly increased after 1980. In Asia, the divergence stopped, and there was a modest move towards closing the income gap starting in 1980. But it was not quite convergence, except in a few countries. There are persistent, and for some regions mounting, differences in the growth rates of GDP per capita.

The doubling of developing countries' share of world manufacturing value added, from 16 percent in 1990 to 32 percent in 2010, stemmed partly from the slowdown in industrial production in the industrialized countries. The

34 For a detailed discussion, see Nayyar 2002 and 2008a.

35 This proposition is set out, with supporting evidence, in Nayyar 2008c. See also Amsden 2007.

Table 11: Growth performance of developing countries: 1951 to 1980 and 1981 to 2005

	GDP growth, % per year				GDP per capita growth, % per year			
	Maddison data		UN data		Maddison data		UN data	
	1951-1980	1981-2000	1981-2000	1981-2005	1951-1980	1981-2000	1981-2000	1981-2005
<i>Asia</i>	6.28	4.04	3.90	4.06	2.90	1.61	1.36	1.63
<i>Latin America</i>	4.69	2.01	2.09	2.26	2.11	0.15	0.20	0.44
<i>Africa</i>	4.12	2.42	2.60	2.97	1.66	-0.17	-0.06	0.39
<i>Developing countries</i>	4.84	2.65	2.74	3.04	2.19	0.39	0.42	0.80
<i>Industrialized countries</i>	4.40	2.56	2.59	2.50	3.50	2.04	2.06	1.96
<i>World</i>	4.77	2.64	2.72	2.95	2.40	0.66	0.69	0.99

Notes: The growth rates for each period are computed as geometric means of the annual growth rates in that period. Figures are provided for 1951 to 1980 based on Maddison data, since UN data are not available before 1971, while 1981 to 2005 are based on UN data. The two data sets are not strictly comparable. However, data are available from both sources for 1981 to 2000. To facilitate comparison, the table presents figures from 1981 to 2000 computed separately from Maddison and UN data. The numbers correspond closely, suggesting that growth rates for 1951 to 1980 and 1981 to 2005, even if computed from different sources, are comparable.

The Maddison data on GDP and GDP per capita, which are in 1990 international Geary-Khamis dollars, are PPPs used to evaluate output and are calculated based on a specific method devised to define international prices. This measure facilitates inter-country comparisons. The UN data on GDP and GDP per capita are in constant 1990 US dollars. Figures for the world economy cover 128 countries, of which 21 are industrialized and 107 are developing. Latin America includes the Caribbean.

Source: Nayyar 2008c based on Maddison 2003 and UNCTAD 2006.

acceleration in production in developing countries is also important and merits attention. It is largely linked to development strategies and economic policies in the post-colonial era that created the initial conditions and laid essential foundations in countries that were latecomers to industrialization. The much-maligned import-substitution-led strategies made a critical contribution to catching up.<sup>36</sup> While a complete explanation would be far more complex, the role of the state was critical. Industrialization was not so much about getting prices right as it was about getting state intervention right.<sup>37</sup> Even in the small East Asian countries, often cited as success stories, the visible hand of the state was much more in evidence than the invisible hand of the market.<sup>38</sup> The degree of openness and the nature of state intervention turned out to be strategic choices in pursuing industrialization. They were shaped by the stage of development to begin with and changes in circumstances over time.

Apart from an extensive role for governments, the use of borrowed technologies, an intense process of learning, the creation of managerial and technological capabilities, and the nurturing of entrepreneurs and firms in different business enterprises were major factors underlying catch-up in industrialization.<sup>39</sup> The creation of initial conditions was followed by

a period of learning to industrialize so that outcomes surfaced with a time lag. It was not the magic of markets that produced a sudden spurt.<sup>40</sup> Experience suggests that success was about laying a foundation in terms of education, infrastructure, capabilities and institutions; managing strategic integration rather than opting for a passive insertion into the world economy; and recognizing the specificities of economies in time and space.<sup>41</sup>

Two sets of factors, interconnected but sequential in time, may underlie trends in developing countries' shares of manufactured exports and manufacturing value added, with the former outstripping the latter since the 1990s.<sup>42</sup> First, for developing countries, external markets became increasingly important in the process of industrialization. This began with Brazil and Mexico in the mid-1960s, although rapid export growth did not continue beyond the late 1970s. Expansion gathered momentum, however, with the East Asian success stories: Hong Kong, the Republic of Korea, Singapore and Taiwan Province of China. The small south-east Asian economies, Malaysia and Thailand, followed in their footsteps. It was not long before China and India, the mega-economies in Asia, also sought access to external markets.<sup>43</sup>

36 See, for example, Helleiner 1992, Rodrik 1992 and Nayyar 1997.

37 There is extensive literature on the subject. See, for instance, Stiglitz 1989, Shapiro and Taylor 1990, Bhaduri and Nayyar 1996, and Lall 1997.

38 This proposition, developed at some length by Amsden 1989, Wade 1990 and Chang 1996, is now widely accepted.

39 For a complete and convincing exposition of this argument, see Amsden 2001. See also Dahlman, Ross-Larson and Westphal 1987, Lall 1990 and Chang 2002.

40 Much the same can be said about the now industrialized countries, where industrial protection and state intervention were just as important at earlier stages of development when they were latecomers to industrialization. This argument, supported by strong evidence, is set out with admirable clarity by Chang 2002. Reinert 2007 develops a similar hypothesis.

41 For a more detailed discussion, see Nayyar 2008c.

42 For time series evidence on these trends, see Nayyar 2009.

43 Export performance in China beginning in 1979, India beginning in 1980, and Brazil beginning in 1964 but only until 1980, was roughly comparable with that in Japan beginning in 1960 and the Republic of Korea beginning in 1965 (Nayyar 2010).

Second, as globalization gathered momentum, there was a progressive integration of developing countries into the world economy, particularly in international trade. Transnational corporations from industrialized countries started sourcing imports of labour-intensive manufactured goods from selected developing countries by relocating production or through sub-contracting.<sup>44</sup> In time, this provided opportunities for domestic firms to manufacture for the world market in collaboration or competition with transnational corporations.

#### 4. UNEQUAL PARTICIPATION AND UNEVEN DEVELOPMENT

Developing countries' increased shares of world output, international trade and manufacturing production may create the impression of widespread development. This is misleading, as much of the catch-up is concentrated in a few countries: China, Hong Kong, India, Indonesia, Malaysia, the Republic of Korea, Singapore and Thailand in Asia; Argentina, Brazil and Mexico in Latin America; and South Africa in Africa. This group of 12 countries is diverse in size and history. Their catch-up processes have not been uniform in terms of starting points or speed. Yet their overwhelming importance is clear enough.<sup>45</sup>

Between 1970 and 2005, within the developing world, their GDP share increased from 62 percent to 68 percent, although their population share decreased from 66 percent to 60 percent. Over the same period, their shares of total exports more than doubled from 33 percent to 73 percent, of total imports rose from 41 percent to 74 percent, and of foreign exchange reserves increased from 41 percent to 76 percent. Between 1980 and 2005, their shares of manufacturing value added rose from 70 percent to 86 percent, and of manufactured exports from 78 percent to 88 percent. Their share of

FDI stocks, both inward and outward, was in the range of two-thirds to three-fourths.

In effect, much of the developing world's catch-up in industrialization and development is concentrated in a dozen countries, where economic growth was associated with a structural change in output and employment, even if it did not lead to improved living conditions for most people.<sup>46</sup>

The obvious determinants of such concentration are size, growth and history. The selected countries, except Hong Kong, Malaysia and Singapore, are large in population, area and income. All the Asian countries experienced high growth rates, even if the step-up started at somewhat different points of time compared with most countries in the developing world. Historically, about half the 12 countries, in particular China and India, but also Argentina, Brazil, Mexico and South Africa, have always been dominant in their respective regions and have also been significant in the world economy.

It is another matter that Brazil and Mexico were success stories before 1980, while China and India were success stories after 1980. The Asian countries in the group created the requisite initial conditions to capture benefits from globalization during the last quarter of the 20th century in much the same way as a few latecomers to industrialization, in particular the United States, grasped advantages from globalization during the last quarter of the 19th century.<sup>47</sup> In contrast, Argentina benefited from globalization from 1870 to 1914, while Brazil and Mexico advanced through import-substitution-based and state-led industrialization from 1950 to 1980. Unlike Asia, Latin America, with the possible exception of Chile, has not quite benefited from globalization since 1980.

The recent impressive but uneven growth of developing countries has three consequences. First, gaps have widened among countries. Second, some countries, or regions within countries, have been excluded from development. Third, widespread poverty persists in a world with pockets of prosperity.

From 1950 to 2010, gaps in income widened not only between rich and poor countries, but also among countries in

44 For a detailed discussion on this issue, see Nayyar 1978.

45 For a further discussion, and for the evidence cited in this paragraph, see Nayyar 2009. The grouping is not significantly different from the 'late-industrializing' countries, described as 'the Rest' by Amsden (2001). The latter include Argentina, Brazil, Chile, China, India, Indonesia, Malaysia, Mexico, the Republic of Korea, Taiwan Province of China, Thailand and Turkey. The grouping in this paper, in comparison, includes Hong Kong, Singapore and South Africa, but excludes Chile, Taiwan Province of China and Turkey. Taiwan Province of China is not included simply because UN statistics do not provide information on it as a province of China. Hong Kong and Singapore are included because they were such an integral part of the East Asian miracle, while South Africa is included as the largest and most industrialized economy in Africa. Both groupings comprise two sets of countries: 'the integrationists' (Mexico, Hong Kong and Singapore), characterized by a heavy reliance on FDI, and minimal local research and development; and 'the independents' (Brazil, China, India and the Republic of Korea), which developed national firms and technological capabilities.

46 This hypothesis is developed, at some length, by Ocampo, Rada and Taylor 2009. The authors attempt to explain divergences in growth and development over the past 50 years among countries that are latecomers to industrialization. The focus is on links across economic structure, policy and growth. The concept of economic structure refers to the composition of production activities, the associated patterns of specialization in international trade, the technological capabilities of the economy, the educational level of the labour force, the structure of ownership, the nature of essential state institutions and the development of (or constraints on) markets, which, taken together, can either hinder or widen policy choices. This approach is used to explain why some countries succeeded in their pursuit of development, but there was a much larger number that did not.

47 For a further discussion on this proposition, see Nayyar 2006.

the developing world.<sup>48</sup> International inequalities were attributable largely to disparities between industrialized countries and developing countries, but even so, those among developing countries were significant. There was a discernible increase during the second half of the 20th century, with a divergence in per capita incomes between rich and most poor countries. Only a few countries, largely in Asia, were exceptions; divergence stopped in the early 1970s, and a modest convergence began to gather some momentum in the early 2000s.

The divergence in per capita incomes among countries in the developing world is new. The least developed countries (LDCs) provide a striking illustration. The number of LDCs doubled from 24 in the early 1970s to 48 in the early 2000s. In 2010, the share of LDCs in world output was less than 1 percent, but, with 830 million people, they accounted for 12 percent of the world population.<sup>49</sup> In nominal terms, the average GDP per capita in LDCs was one-fifth of that in developing countries and one-fiftieth of that in industrialized countries. Economic development simply did not create social opportunities for most people.

In 2009,<sup>50</sup> adult literacy in the LDCs was less than 60 percent compared with more than 80 percent in developing countries. Life expectancy at birth was 56 years and the infant mortality rate was 78 per 1,000 births, compared with developing countries' 62 years and 48 per 1,000 births. Gross enrolment ratios in tertiary education were less than 6 percent in the LDCs compared with more than 20 percent in developing countries. The exclusion of the LDCs from development is an important factor underlying international inequalities in the world as a whole and within the developing regions.

There is similar exclusion of regions within countries. This is not altogether new. But markets and liberalization tend to widen disparities, because there is a cumulative causation that creates market-driven virtuous or vicious circles. Regions that are better endowed with natural resources, physical infrastructure, and educated or skilled labour experience rapid growth. Like magnets, they attract resources from people elsewhere. In contrast, disadvantaged regions tend to lag behind and become even more disadvantaged. Over time, disparities widen. This has happened in most countries that have experienced rapid growth. In Brazil, regional inequalities

between the north-east and the south, in particular São Paulo, increased significantly during rapid economic growth. Economic disparities have widened between coastal China in the east and the hinterland in the west; between Java and the other islands of Indonesia; and between India's western and southern regions, and eastern and northern regions.

The incidence of poverty in the developing world in 1950 was high. By 1980, there was a modest reduction in the proportion of people below the poverty line, but this was nowhere near what was needed to diminish, let alone eradicate poverty. The period since then has witnessed a change for the worse in many places.<sup>51</sup> The incidence of poverty increased in most countries of Latin America, the Caribbean and sub-Saharan Africa during the 1980s and the 1990s. Much of Central Asia experienced a sharp rise in poverty during the 1990s. East Asia, South-east Asia and South Asia experienced a steady decline, but mainly in China and India.

Between 1981 and 2005, the proportion of people below the poverty line of PPP \$1.25 per day dropped from 51.8 percent to 25.2 percent of the global population, whereas the number of the poor dropped from 1.9 billion to 1.4 billion. If the poverty line is drawn at PPP \$2 per day, between 1981 and 2005, the number of poor in the world remained unchanged at 2.5 billion, even if their proportion in the total population dropped from 69.2 percent to 47 percent. The population between the two poverty lines, 1.1 billion people, more than one-fifth the number of people in the developing world, is vulnerable in times of crisis, because any shock, such as a bad harvest, high inflation or employment cuts, can push them further into poverty.

The evidence cited here is based on World Bank estimates.<sup>52</sup> Some argue that these underestimate poverty, while a few claim that they overestimate it.<sup>53</sup> It is clear that more than one-fifth and perhaps almost two-fifths of people live in absolute poverty, depending upon the poverty line. They live mostly in the developing world and constitute a significant proportion of its population. And poverty has persisted at high levels during a period when developing countries took a greater share of world income.

The beginnings of a catch-up with the industrialized world seem concentrated in just a few countries, meaning there is convergence for a few but divergence for the many. If rapid growth has led to human development and social progress in a few countries, in a much larger number growth has not

48 This argument is developed, with supporting evidence, elsewhere by the author. See Nayyar 2009. For a comprehensive analysis of trends in international inequality, among countries and people, see Milanovic 2005.

49 The LDC shares of world GDP and population are calculated from the UN Conference on Trade and Development (UNCTAD) online database on LDCs.

50 The statistics cited in this paragraph are obtained from UNCTAD 2011.

51 See World Commission on the Social Dimension of Globalization 2004 and Nayyar 2006.

52 See Chen and Ravallion 2008.

53 There is extensive literature on the subject. For a succinct discussion of the trends in poverty and the debate on numbers, see Kaplinsky 2005.

quite led to development. A significant number of countries have not experienced either growth or development.

In the aggregate, evidence suggests some progress on the Human Development Index, which shows that the gap between rich and poor countries has narrowed by about one-fifth between 1990 and 2010, and by about one-fourth since 1970.<sup>54</sup> Some of this convergence may be attributable to the fact that two indicators that make up the index, literacy rates and life expectancy, have natural upper bounds. The narrowing of the gap may also be attributable to the base year, or the starting point for the comparison, when levels of human development, particularly in terms of health and literacy, were low in most poor countries.

On the whole, there has been progress, although its distribution is unequal across and within countries. Per capita incomes are just arithmetic means, while social indicators are mere statistical averages. And neither captures the well-being of the poor. Measures of poverty, ranging from simple to complex, highlight the reality that absolute deprivation, even if it has diminished over time, persists and is widespread.

## 5. CONTEMPLATING THE FUTURE

Is it possible to speculate about the future prospects of developing countries in the world economy? Growth matters because it is cumulative. Statistical projections based on an extrapolation of the recent past into the distant future, however, even if these are the fashion of the times, cannot predict outcomes. Such projections highlight the power of compound growth rates, but growth is not simply about arithmetic. In fact, it is about more than economics. And there is nothing automatic about growth.

There are underlying factors that suggest a strong potential for growth. But there are also real constraints. In the ultimate analysis, the constraints can be overcome in a sustainable manner only if economic growth is transformed into meaningful development that improves the well-being of all people. If this happens, it would reinforce growth and development through a cumulative causation. If it does not, developing countries will find catch-up difficult and will continue to lag behind the industrialized world.

The economic determinants of potential growth in the developing world are a source of good news. In principle, developing countries may be able to attain or sustain high rates of growth for some time to come for the following reasons.

First, their populations are large and their income levels are low, allowing greater possibilities for growth. Second, their demographic characteristics, in particular the high proportion of young people, implying workforce increases for some time to come, are conducive to growth, provided that education is widely available and creates the right capabilities. Third, wages are significantly lower in most developing countries than elsewhere, which is an important source of competitiveness. In manufacturing activities, large reservoirs of surplus could mean that relatively low wages could continue to be a source of competitiveness for some time. Fourth, the potential for productivity increases is considerable at earlier stages of development at the extensive margin, from almost zero productivity in agriculture to some positive, even if low, productivity in manufacturing or services, followed by a transfer of such labour from low productivity employment to somewhat higher productivity employment at the intensive margin.

In practice, developing countries may not be able to realize the potential for growth. There are specific constraints in different countries, whether leaders or laggards. General constraints common to most developing countries include poor infrastructure, underdeveloped institutions, inadequate education, unstable politics and bad governance. Potential constraints that may not be discernible so far but may arise from the process of growth encompass economic exclusion, social conflict, environmental stress and climate change. Some constraints may be exogenous to developing countries, such as worsening terms of trade, restricted market access for exports, inadequate sources of external finance or a crisis in the world economy.

In pursuing development, poverty eradication, employment creation and inclusive growth are imperatives. These constitute the essential objectives of development, and they are the primary means for bringing about development.<sup>55</sup> This is the only sustainable way forward for developing countries, because it would enable them to mobilize their most abundant resource, people.

There is a complexity in the process of development. Yet some initial conditions and essential foundations are almost obvious. The spread of education provides a basis for development in countries that are latecomers to industrialization. Infrastructure, both physical and social, is fundamental for

54 For a detailed discussion, with supporting evidence, see UNDP 2010.

55 This argument is similar to Amartya Sen's conception of development as freedom. He argues that development is about expanding real freedoms that people enjoy for their economic well-being, social opportunities and political rights. Such freedoms are not just the primary ends of development, but are also instrumental as the principal means of attaining development. For a lucid analysis, see Sen 1999.

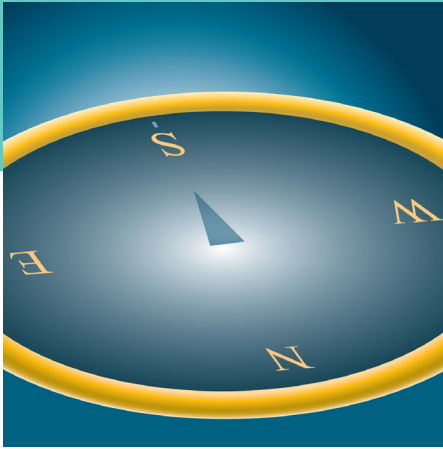
earlier stages of industrialization. Most important, perhaps, is the state's critical role in terms of policies, institutions and governance. Developing countries must endeavour to combine economic growth with human development and social transformation. This requires a creative interaction between the state and the market, beyond the predominance of the market model. Their past could then be a pointer to their future.

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